

MARKETS AND INVESTMENTS

ATRS has had a strong run in the markets since July 1 2010. The markets have been great the last 45 days. The Dow Jones Industrial Average closed above 11,000 today for the first time since early May of this year when the markets fell hard (remember the “flash crash”). You may also have seen the report in the media this week that ATRS rose in value by \$950 million dollars between July 1, 2009 and June 30, 2010. The increase in value was actually higher if you consider that ATRS uses about \$200 million dollars a year from the trust fund to pay retiree benefits. The \$950 million dollars was after the reduction due to benefits that were paid using trust fund assets. The markets have been very choppy since late April of this year with recent positive aspects to the choppy progression. June was negative, July was positive, August was negative, September was VERY positive, and October has been very good so far. September was the best September in the markets in about 70 years!

Based on flash reports and detail that ATRS has collected in recent days, it appears that the ATRS trust fund is worth over \$10.5 billion dollars today. Current flash reports show a value today of over \$10.4 billion dollars. With gains from managers that report after the close of their September books, ATRS expects well more than \$100 million dollars in additional gains. The flash report shows ATRS up over 7% in the public markets since June 30th. A copy of part the flash report from yesterday's close (October 7, 2010) is attached. It shows a one-day increase of \$98 million dollars, however some of the day's increase was due to September updates from managers that only report monthly.

ATRS remains committed to an asset allocation that is carefully diversified across many asset classes and across the world. The ATRS Board has done an excellent job in finding the best mix on allocation of assets and by finding and hiring the best managers in the asset classes. ATRS has performed well when compared to other pension plans and to the benchmarks that ATRS uses to measure the real value added by active management of assets.

ATRS owns timberland in eleven states. The total value of the ATRS timberland holdings is over \$300 million dollars. The total timberland acres are just over 210,000 acres (that is over 300 square miles). ATRS has added over 20,000 acres (that is over 30 square miles) of Arkansas timberland this year to the trust fund. The purchases were outstanding based on land quality, location relative to mills and processing facilities, and price. At a time when many corporate owners are selling timberland to reduce debt or meet cash flow needs, ATRS has been buying. By ATRS having cash to purchase large tracts without the need to finance the purchases, ATRS has been able to move quickly to acquire the timberland at attractive prices relative to even the current market values.

ATRS is in a position to let the timber grow on the stump until ATRS is ready to sell. ATRS has a quality timberland manager that knows how to manage for best pricing of sales. For instance, it knows how to save "all weather tracts" for winter and wet weather harvest and to let the trees grow in weak market conditions that add volume and value when markets rebound. ATRS expects excellent returns even if current prices in timber

continue at today's levels. If the housing markets pick up along with consumer spending, the expected returns due to better wood and fiber prices will be outstanding. ATRS still has about \$50 million dollars that the manager can use to acquire more Arkansas timberland if good deals continue to become available.

ATRS is also looking to add a new alternative investment in farmland. Farmland has been a great investment opportunity historically. ATRS is now at a size that it can allocate enough funding to a farmland manager in a separate account for ATRS to purchase enough farmland in Arkansas and other states for proper diversification. The ATRS staff and the real estate consultant are undertaking a review to find the best national farmland manager to recommend to the ATRS Board for this new potential investment opportunity. Several farms are for sale in Arkansas at this time. Some pension plans are re-balancing allocations and may have some farmland assets for sale in other states. Farmland has the positive characteristics of good cash flow, price appreciation, performance that does not directly follow stock market cycles, and stability in economic downturns. ATRS will work to find the best manager to recommend to the ATRS Board in the near future.

OTHER ISSUES

ATRS had its June 30, 2009 audit filed by the Legislative Joint Auditing Committee. The audit had no findings. This does not mean that ATRS was perfect. The ATRS Board and ATRS staff have worked hard to address all issues of concern and make improvements. The operation of ATRS is complex with many moving parts. Often issues of federal tax law, state laws, accounting standards boards requirements, and policy is hard to reconcile when several apply to the same issue. Benefit calculations become more complex as options available to members are expanded. Mistakes will be made. ATRS will work hard to examine its mistakes to learn from them. ATRS is committed to address weaknesses and prevent as many mistakes as possible. ATRS has an internal auditor committed to work with the legislative auditors and ATRS staff to more quickly address problems and questions.

ATRS is also looking to help address member needs. One change that the ATRS Board has asked ATRS staff to work on is to allow members exiting T-Drop to be able to leave some of the T-Drop proceeds with ATRS and transfer some to another administrator. Currently, a member must either leave the entire amount with ATRS or transfer the entire balance out of ATRS. This potential change will allow the member to leave 25%, 50%, or 75% with ATRS while transferring the remainder elsewhere. If approved, this change will be available for the July 2011 retirements by T-Drop participants.

ATRS is looking at a few other benefit issues. ATRS does not expect any significant changes to the overall structure of benefits in the upcoming legislative session. ATRS did not ask for any addition staff at ATRS for the next two years in its legislative budget request. ATRS hopes to improve on efficiency and hold the line on expenses. At the same time, ATRS will have many new members and additional retirees over the next 5 to 10 years. Additions to staff will be a necessity in the future to ensure member needs are

met. The ATRS Board has focused on addressing costs. As January approaches, ATRS will be providing regular updates on legislation once the ATRS legislative package is finalized. Plus other legislative bills of interest to retirement systems will also be followed as part of those updates during the legislative session.